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SUBJECT: NICARAGUA: CAFTA UPDATE

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¶1. (U) Summary: Nicaraguan exports to the United States during the first year of CAFTA performed extremely well. Total exports to the United States increased 29.2%, growing from $1.18 billion in 2005 to $1.53 billion in 2006. The Nicaraguan government separates free trade zone exports and general exports, which explains why its statistics are quite different from those we report. Top Nicaraguan exports to the United States fell into three product categories: knit apparel, woven apparel, and automobile wiring harnesses, all manufactured primarily in free trade zones. Other Nicaraguan exports to the United States showing the strongest performance on the year included coffee, sugar, vegetables, tobacco products, and gold. Reflecting changing patterns of trade, both the number of products exported and number of Nicaraguan companies engaged in export to the United States increased.

¶2. (U) Nicaragua imported almost 21% more from the United States in 2006 than it did in 2005. Leading imports include machinery, cereals, electrical machinery, vehicles, optical equipment, fats and oils, and plastic products. Most of these imports are going into production of some kind. According to the Ministry of Trade, Industry and Development (MIFIC), imports of capital goods accounted for 22% of total imports from the United States in 2006, intermediate goods almost 29%, and petroleum products 13%.

¶3. (U) At least $235 million in new investments have been "highly influenced" by Nicaragua's membership in CAFTA. Investments on another $233 million in this same category are currently under consideration. These "highly influenced" investments are predominantly in textiles and apparel industries. End Summary.

Exports to the United States

¶4. (U) Nicaraguan exports to the United States during the first year of CAFTA performed extremely well. Total exports to the United States increased 29.2%, growing from $1.18 billion in 2005 to $1.53 billion in
¶2006. Since CAFTA entered into force on April 1, 2006, exports to the United States grew 28.5% compared to the same period in 2005. Top exports to the United

States fell into three broad product categories: knit apparel, woven apparel, and automobile wiring harnesses, all manufactured primarily in free trade zones. These three categories accounted for approximately $1 billion in trade with the United States, up 20% from 2005.

¶5. (U) Other exports to the United States showing strong performances in 2006 were as follows:

-- coffee and spices, up 82% to $67 million, largely because of high coffee prices;

-- sugar, up 62% to $26 million, largely because of a second tariff rate quota afforded to Nicaragua under CAFTA;

-- vegetables, up 55% to $11 million, largely because of the export of new products to the United States under CAFTA;

-- tobacco products, up 18% to $26 million, largely a reflection of growing U.S. consumer demand for Nicaraguan cigars; and

-- gold and precious stones registered an increase of 12% to $ $23 million, largely a reflection of high gold prices in 2006.

Statistical Discrepancies

¶6. (U) We must note that for national income and accounting purposes, the Government of Nicaragua draws a clear distinction between free trade zone exports and general exports, tracking the two as if they were separate statistics. Additionally, there are other discrepancies with the way Nicaragua collects data on exports. As the following paragraph demonstrates, U.S. officials should be careful to state that our trade figures are based on U.S. Customs data, and include free trade zone exports to the United States.

¶7. (U) The Ministry of Trade, Industry and Development (MIFIC) reports trade statistics on the impact of CAFTA that are quite different from those of the United States International Trade Commission (USITC). For example, since CAFTA entered into force on April 1, 2006, MIFIC reports that exports to the United States rose 10.1%, to $239 million, while imports from the United States rose 28.5%, to $498 million. For MIFIC, these flows translate into a bilateral trade deficit with the United States of $259 million, 52% more than in 2005. The report notes that major Nicaraguan exports to the United States include coffee, seafood, beef, sugar, tobacco products, gold, and vegetables. The difference between MIFIC and USITC statistics is mostly, but not completely, explained by MIFIC's exclusion of free trade zone imports and exports.

A Look at CAFTA Quotas

¶8. (U) CAFTA established a series of tariff quotas for Nicaragua for some strategic agricultural products, including beef, sugar, peanuts, peanut oil, cheeses, dairy products, ice-cream, milk and cream. Indeed, these products are among Nicaragua leading exports to the United States. Nicaragua fully utilized its cheese and sugar quotas under CAFTA in 2006, but underutilized its quotas on peanut butter, ice-cream, milk and cream. Nicaragua did not utilize its CAFTA beef quota because it had not first exhausted its quota provided by the United States under the World Trade Organization.

¶9. (U) While Nicaraguan peanut production has rapidly

grown in recent years, local producers managed to fill only 14.9% of their quota under CAFTA. Nicaraguan officials have told us that this is because U.S. producers of peanuts are very competitive in their home market. The Government of Nicaragua believes that its producers can compete with U.S. producers in third country markets, particularly Mexico, but that U.S. credit guarantees give U.S. peanut exporters an unfair advantage. For this reason, Nicaragua joined Canada, Argentina, Australia and others in a recent request for WTO consultations on the application of U.S. agricultural subsidies.

Changing Trade Patterns

¶10. (U) One of the most important CAFTA developments may at first seem insignificant because the export quantities are so small. MIFIC reports that since CAFTA entered into force, Nicaragua exported 274 products to the United States for the first time, including cotton underwear and nightgowns, chili peppers, billiard accessories, razor blades, ornamental fish, papaya, and plantains. Some of these products, or groups of products, promise to become significant export categories for Nicaragua in the future and, thus, greatly diversify Nicaraguan exports to the United States and the rest of the World.

¶11. (U) A look at which companies are exporting also reflects changing trade patterns. MIFIC reported that 372 Nicaraguan companies exported during April-December of 2006, the nine-month period after which CAFTA took effect. While 10 leading companies accounted for slightly more than 46% of total exports to the United States, 235 companies exported less than $100,000. The number of companies exporting more than $100,000 grew 15%, to 126. The total number of companies exporting to the United States grew by 4% over that of 2005, while the average exported by each company grew by 6%. In short, more companies are exporting more product, and more types of products, to the United States than before CAFTA. Again, while these movements are small, they point to changing trade patterns for Nicaragua.

Imports from the United States

¶12. (U) Using USITC statistics, Nicaragua imported almost 21% more from the United States in 2006 than it did in 2005, growing to $755 million from $625 million. Since CAFTA entered into force, Nicaraguan imports from the United States increased almost 17% when compared to same period in 2005. Leading imports from the United States include machinery, cereals, electrical machinery, vehicles, optical equipment, fats and oils, and plastic products. Most of these imports are going into production of some kind. MIFIC trade statistics for 2006 show that imports of capital goods accounted for 22% of total imports from the United States in 2006, intermediate goods almost 29%, and petroleum products 13%. Consumer goods accounted for 35% of total imports from the United States in ¶2006. Reflecting the depth of the U.S. economy, imports are more evenly distributed over a wider range of products than are Nicaraguan exports to the United States.

Investment

¶13. (U) ProNicaragua, the government investment promotion agency, reports that at least $235 million in new and active investments were highly influenced by Nicaragua's membership in CAFTA. The largest of these is U.S.-based ITG Cone Denim new $100 million textile plant currently under construction in Ciudad

Sandino. Half of the fifteen enterprises involved are already operating -- all but one are manufacturers of textiles or apparel. Together, these companies will directly employ more than 13,000 Nicaraguans. Another sixteen enterprises, mostly in textiles and apparel, are considering investing another $233 million as a result of Nicaragua's membership in CAFTA. If these new investments materialize, they would directly employ another 9500 Nicaraguans. Nicaragua membership in CAFTA has also inspired a number of companies to re-invest in existing operations and the expansion production.

Conclusion

¶14. (SBU) Though still early days, Nicaragua is clearly benefiting from CAFTA. Exports are up and more companies are trading a growing variety of goods. Once companies begin to export, they become more confident in their abilities to do business in new markets and with new products. Anecdotal evidence suggests that a growing number of small- and medium-sized businesses are borrowing to invest in the manufacture of components and other items for export.

¶15. (SBU) USITC trade statistics reveal that no country has benefited more from CAFTA at this early juncture than Nicaragua. This partially reflects the fact that Nicaragua started from a lower base than its Central American neighbors, with fewer industries enjoying effective tariff protection. It partially reflects the fact that Nicaragua clothing and apparel industry was not well integrated into regional supply chains that experienced disruption when fellow countries implemented CAFTA on different dates. It also may reflect certain competitive advantages for Nicaragua. For example, the country has plenty of arable land and water for agriculture. Nicaragua offers textile and apparel manufacturers the lowest labor wages in Central America. Nicaragua has the only Trade Preference Level (TPL) among CAFTA countries, allowing it to import low cost third country fabric for the manufacture and export of apparel to the United States. Nicaragua also has the lowest crime rate in Central America. Despite the lack of infrastructure and irregularities in the legal system, these factors make the country a relatively attractive place to invest, particularly in agriculture and light manufacturing.

¶16. (SBU) Equally significant is that the administration of former President Enrique Bolanos worked hard to improve customs, tax collections, and reduce red tape for investors. Bolanos stabilized inflation, reduced foreign debt, grew foreign exchange reserves, and stabilized foreign exchange rates. In addition, his administration successfully marketed the country to investors, providing tax and investment incentives when necessary. On January 10, Bolanos handed power over to newly elected President Daniel Ortega, and left the job of promoting Nicaragua to a new administration with a very different approach to government. The jury is out as to how hard Ortega administration will work to fulfill the promise of private sector-led growth and development that membership in CAFTA holds for Nicaragua.
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